

ECONOMIC IMPACT STATEMENT

GUIDELINES

as related to the STD. 399 form discussed in
STATE ADMINISTRATIVE MANUAL (SAM) Section 6680



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GUIDELINES for the Economic Impact Statement in STD. 399

INTRODUCTION

The revised STD. 399 form combines the Fiscal Impact Statement (FIS) with a new Economic Impact Statement (EIS) required under Executive Order W-144-97 issued by Governor Wilson. The Order states that "The economic impact statement shall provide for consistent application of all existing statutory requirements for economic analysis of regulations, shall be used as the basis for the determination of fiscal impacts, and shall be incorporated into the fiscal impact statement required for proposed regulations." Guidelines for the EIS are set forth in the following paragraphs. (See SAM sections 6600-6670 for the FIS instructions; and 6680 for general EIS instructions.)

The EIS is intended to provide a clear and concise summary of the economic impacts of proposed regulations. It is not a replacement for a rulemaking record, nor for the analysis and documentation it must contain. Each state agency is required to provide in the rulemaking record facts, evidence, documents, testimony, or other evidence it relied upon to support its impact findings. [See California Code of Regulations (CCR) Title 1, Chapter 1, Article 2, section 10, and Government Code (GC) § 11346.5(a)(8)]. As a result, the EIS information can only be presented on the STD. 399 after an impact analysis is performed. The EIS is also not a substitute for any other requirements in the California Administrative Procedures Act (APA), or Health and Safety Code (H&SC) § 57005 concerning major California Environmental Protection Agency (Cal/EPA) regulations.

Not every question in the EIS is applicable to every proposed regulation. The EIS is designed to summarize the various types of impacts that could occur as a result of the hundreds of regulations that are proposed by state agencies each year.

Numerous questions request dollar amounts or other numeric values. Regulatory agencies should provide quantitative responses to such requests whenever possible. If it is not possible to provide a precise numeric response, an estimated range or order of magnitude should be given. If it is not possible to respond quantitatively, a qualitative response should be provided that contains sufficient detail to clarify the nature or magnitude of impacts. Unacceptable qualitative responses, when used without clarifying information, include vague terms such as "few", "minor", and "occasional". Unacceptable single-word responses also include "inapplicable" and "unknown". If a question in the form is not relevant for a particular regulation, or does not affect a specific group, then that should be explicitly stated. When the specific information requested is not available, a reason should be given. However, any information that is available or known should be provided.

Part 1 provides a brief overview of economic impact analysis. The APA requires that an impact analysis be conducted, as documented in numerous places in the EIS guidelines, but does not discuss the analytic techniques needed to conduct the analysis and produce the impact information required for the rulemaking record. The overview describes the generally acceptable approaches and practices that constitute a standard impact analysis. Additional information on impact analysis is provided later in these EIS guidelines, as related to specific questions in the EIS and rulemaking law.

Part 2 describes the procedures for filing the STD. 399 form, while Part 3 provides guidelines specific to each of the subject areas and individual questions in the EIS. Included throughout are citations from the APA and H&SC that document the reporting requirements contained in the form.

AN OVERVIEW OF IMPACT ANALYSIS

Part 1

Economic impact analysis is a standard technique for measuring the effects of government actions, and for presenting the results in a way that helps policy makers make appropriate choices. It is used by the federal government and most of the states, including California, to assess the economic effects of a proposed regulation. A complete impact analysis includes an evaluation of all the anticipated costs and benefits of a proposed regulation, and any alternatives to that regulation that are potentially effective and reasonably feasible. (For the purposes of the EIS, agencies need only include *direct* costs and benefits on regulated parties.)

GUIDELINES for the Economic Impact Statement in STD. 399

There is no single formula, technique, or methodology for conducting an impact analysis of the myriad of regulations proposed by state agencies. The analysis of costs, benefits, and alternatives involves uncertainties, and requires informed professional judgments that take into account the many features of a regulation. An understanding of impact analysis will often help to select the best regulatory approach, even when all the quantitative techniques of such an analysis cannot be used.

There is no standard amount of time or resources that should be expended on an impact analysis. Regulations vary widely and the staff work devoted to an economic impact analysis should be commensurate with the size, scope, and complexity of the regulation.

The EIS portion of the STD. 399 form is intended to facilitate the organization of the impact analysis required of regulatory agencies. The questions and topics generally incorporate the following basic steps in preparing an economic impact analysis: (1) Specify the problem, and the current and future impacts of not addressing the problem; (2) Consider possible alternatives to the regulation, including market-based solutions and not regulating; (3) Conduct a cost analysis that identifies affected parties and estimates the value of costs; (4) Conduct a benefit assessment that identifies affected parties and estimates the value of benefits; (5) Compare benefits and costs, including the magnitude and incidence of these impacts; and (6) Select a regulatory approach. Ideally, the proposed regulation should have the highest net benefit of possible regulatory approaches. If this determination cannot be made, the proposed regulation should have benefits that exceed costs.

The assessment of costs and benefits may be facilitated by the use of spreadsheets to produce tables of the various impacts on regulated parties. The display of impact information in tables is an approach that is required, or recommended, by a number of other states. Although there is no single format that will work for every regulation, there are standard formats that are typically used. For example, the costs of a regulation that affects a variety of industries can be depicted in a table where each row represents a particular industry and each column represents a specific type of impact. Summing across rows would yield total costs to a particular industry, while summing down columns would yield all-industry costs. (Benefits could possibly be presented in a similar fashion.) In addition to providing a more clear and accurate summary of impacts, spreadsheets can simplify the calculation of the present value of costs and benefits over time.

A tabular approach is also useful when impacts cannot be quantified in a meaningful way. A table could be used to present all positive and negative impacts of a proposed regulation. Another table could identify the various industries or affected parties that are expected to gain or lose.

FILING THE ECONOMIC AND FISCAL IMPACT STATEMENT (STD. 399)

Part 2

Every agency subject to the provisions of Chapter 3.5 of the Government Code (GC) is required to file with the Office of Administrative Law (OAL): a Notice of Proposed Adoption, Amendment or Repeal (*Notice*); the proposed text of the regulation; the Initial Statement of Reasons (ISOR); and other related documents. This information must be submitted to OAL at least 10 calendar days before the desired publication date in the California Regulatory Notice Register. [CCR Title 1, Chapter 1, Article 2, section 5].

Agencies must include with this submittal a completed and signed STD. 399 form for each proposed rulemaking. The form consists of two parts, an Economic Impact Statement and a Fiscal Impact Statement. It is not necessary to complete the Economic Impact Statement for emergency regulations. However, that statement must be prepared and submitted when permanent regulations are proposed simultaneously with an emergency filing.

The following are the steps that all agencies must follow when filing the STD. 399 form:

1. After an agency has completed the STD. 399 as fully and accurately as possible, the form must be signed by the Agency Secretary. State boards, offices, or departments not under an Agency Secretary must have the form signed by the highest-ranking official in the organization. The signature attests that the agency

GUIDELINES for the Economic Impact Statement in STD. 399

has completed the STD. 399 according to the instructions in SAM sections 6600-6680, and understands the impacts of the proposed rulemaking.

2. A copy of the agency-signed STD. 399 must be transmitted to Department of Finance (DOF) for signature when SAM sections 6600 - 6670 require completion of the Fiscal Impact Statement. The DOF-signed STD. 399 should be returned to the agency for inclusion with the rulemaking documents that the agency must submit to OAL prior to the publication of its proposed rulemaking.
3. If DOF signature is not required, because the agency is not required to complete the Fiscal Impact Statement portion of the form, the agency must still submit the STD. 399 to OAL with the *Notice* and other documents required prior to the publication of a proposed rulemaking. DOF must receive a copy of any STD. 399 that is submitted to OAL. Although the form may contain only economic impact information, DOF may examine such information for its possible implications on fiscal impacts.
4. A copy of the STD. 399 must be transmitted to the Trade and Commerce Agency, Regulation Review Unit (RRU), at the same time the *Notice* and other required documents are submitted to OAL. [Executive Order W-144-97]. RRU is responsible for reviewing the economic impact assessments prepared by state agencies for their proposed rulemaking, and will carefully scrutinize the economic information in the STD. 399. (A further description of the role and responsibilities of RRU in the regulatory process can be found in GC §15363.6, Health & Safety Code § 57005 and on the RRU Web site: <http://commerce.ca.gov/regreview>.)

Agencies should also provide a copy of the *Notice*, ISOR, and proposed regulation text to RRU along with the STD. 399, since RRU requests and examines these documents for all proposed rulemaking.

If RRU subsequently submits written comments regarding the Economic Impact Statement in the STD. 399, or any other aspects of a proposed rulemaking, "...all state agencies and departments shall respond to the Trade and Commerce Agency's comments." [Executive Order W-144-97]. The agency response must be in writing, and specifically directed to RRU. In addition, an agency may send RRU copies of any written responses it provided to other groups and individuals.

GUIDELINES FOR COMPLETING THE EIS PORTION OF THE STD. 399

Part 3

A. Estimated Private Sector Cost Impacts

The purpose is to identify the general types of private sector impacts that may result from the proposed regulation. Identifying affected parties and specific regulatory requirements is particularly important when there is a potential cost impact. Agencies should check the appropriate box(es) to indicate where impacts may occur. This step is critical to performing a complete and accurate economic impact analysis. Beneficial impacts on the private sector should be identified separately in item C. Estimated Benefits of the EIS. (The terms "impact" and "affect" are used interchangeably in the APA, and are synonymous terms in the EIS.)

Businesses and/or individuals are presumed to be directly impacted if: (1) they are legally required to comply with or enforce the regulation; (2) they derive some benefit as a result of the regulation; or (3) they incur some detriment as a result of the regulation. [CCR Title 1, Chapter 1, Article 2, sections 4 and 16]. All state agencies adopting, amending or repealing regulations, are required to identify and assess the impact of those regulations on businesses and/or individuals [GC §11346.3 and 11346.5(a)].

A1 Check the box(es) that most closely describe the private sector impacts that may result from the proposed regulation. If the private sector will not be impacted in any way, check box "h" and briefly explain how this determination was made.

These impacts are identified in the APA, and are cited and discussed throughout these guidelines. However, for the purpose of selecting the appropriate box(es), agencies may want to review the following specific

**GUIDELINES for the
Economic Impact Statement in STD. 399**

definitions in the statutes: small business [GC § 11342(h)]; performance standard vs. prescriptive standard [GC § 11342(d) and (f)]; and reporting requirements [GC § 11346.3(a) and (c)].

New or expanded reporting, record keeping and permit requirements typically impose costs on businesses and/or individuals. If box “e” is checked, these costs must be estimated in item B3 of the EIS.

A2 Estimate the total number of businesses that are likely to be impacted by the regulation. If there are more meaningful indicators than number of businesses, such as business revenues or profits, provide a summary here and include a detailed explanation in the rulemaking record.

Provide a brief description of the type of businesses impacted. For example: “gas station” or “oil refinery” may be more descriptive of the impacted businesses than “petroleum industry”. Standard Industrial Classification (SIC) codes, which was replaced by the North American Industry Classification System (NAICS) in 1997, may also be used to designate the industry that best describes the predominant activity in which the impacted businesses are engaged.

Estimate the number or percentage of total businesses that are small businesses.

A3 Estimate the number of new businesses that may be created, and/or eliminated as a result of the regulation. Provide a brief explanation, if necessary, including whether businesses may also be expanded or diminished. Although it may not be possible to precisely estimate the number, GC §11346.3(b)(1)(B and C) requires that the agency “assess whether and to what extent” businesses will be created, expanded and/or eliminated.

A4 Most regulations are enforceable throughout California, but as a practical matter, they may impact only certain geographic areas. For example, a regulation concerning development on the California coast may not impact businesses operating in inland areas. Identify where impacts may occur, or if unknown, check “Statewide”.

A5 If it is anticipated that new jobs will be created and/or eliminated as a result of the regulation, estimate the total number in each category by industry and/or occupation. Also note in the description of impacts if the regulation establishes requirements that restrict entry into jobs or occupations.

A6 GC § 11346.3(a)(2) requires regulatory agencies to assess the extent to which a proposed regulation would impact the ability of California businesses to compete with businesses in other states. Other states or regions may gain a competitive advantage if businesses outside of California are able to produce goods or services at a lower cost than businesses in California. Describe the products or services that California businesses may find more expensive to produce. If the regulation will impact international trade, that information may also be described here.

B. Estimated Costs

In order to determine the economic impact of a proposed regulation, all costs should be identified and correlated with those who will bear the financial burden of the regulation.

The purpose is to identify all costs associated with the implementation of the proposed regulation. GC § 11346.5(a)(9) defines “cost impact” as, “... the reasonable range of costs, or a description of the type and extent of costs, direct or indirect, that a representative private person or business necessarily incurs in reasonable compliance...” with the regulation. Some examples of costs that should be considered are as follows:

- **Costs to Businesses.** The most direct and measurable costs to businesses are government fees, charges, and assessments. Compliance costs may be more difficult to estimate than fees, charges and assessments, but are often more expensive to businesses. Businesses may incur capital costs for the

GUIDELINES for the Economic Impact Statement in STD. 399

purchase of new equipment or structures. They may also incur operational costs, such as hiring additional staff; and, purchasing additional supplies. Depending upon the regulations, it may also be necessary for a business to hire consultants, train staff as to the operation of new equipment or new processes, or pay for testing laboratories or other professional services. Some businesses may be able to comply with the regulations using existing staff and resources. However when the staff and resources are used for regulatory compliance activities, they are unavailable to generate revenues for the business. This latter cost impact is generally referred to as an opportunity cost. One of the major opportunity costs is the expense of time delays. Not only are interest costs and other expenses incurred from the delay of business activity, but the business often loses opportunities in the market place that may not exist later.

Businesses also incur information and transaction costs. These costs reflect the time, and associated expense, of learning about the regulations, making informed decisions about equipment purchases or operational changes which may be needed, and preparing and maintaining any records required by the regulations' provisions.

- **Costs to Individuals.** The costs to individuals are often of the same type as for businesses, such as compliance costs, information and transaction costs, and the payment of fees and assessments. Individuals may also be affected by higher product prices, or a reduction in product choices or features, as a result of regulations.
- **Other Costs.** Regulations can impose costs that affect large portions of the private sector, or the statewide economy. Economic productivity may be reduced as businesses and/or individuals devote their labor, capital, and resources to comply with regulations. Regulations can change the operations and structure within an industry by raising costs and reducing the number of firms. Regulations can also alter existing production processes, products, and technologies, and make it more difficult to develop future products and innovations. Not all of the costs of regulations may be readily apparent. It is not known how many businesses do not get started, or the number of people who are not employed, due to excessive or poorly designed regulations. Large or intrusive regulations can actually override market forces in the economy. These costs, if known or anticipated, should be summarized, in narrative form, in item B1(d) of the EIS.

State agencies adopting new regulations, or amending existing regulations are required to consider the impacts of the regulations that may be incurred by businesses and/or individuals [GC § 11346.2(b)(5), 11346.3, 11346.5(a)(7,8,9), and 11346.9(a)]. Item B. Estimated Costs of the EIS is designed to facilitate an analysis of potential cost impacts.

B1 This item requests an estimate of the total costs, both present and future, for all impacted businesses and/or individuals in California. Include those costs that have been separately identified in items B3 through B5. If future costs are expected, they should be discounted to present values using the methods discussed in the next two paragraphs. It is not appropriate to simply sum the future costs. This approach ignores the time value of money. *Note:* The requirement for detailed cost information should be considered in light of the nature of the regulations. Regulations that implement minor technical changes in the law or have insignificant impacts may not require a present value analysis.

Present value analysis, or discounting, is generally used to convert income and expenses realized in different times to common units or present values. Discounting is therefore a fundamental tool for comparing costs and benefits accruing at different time periods. The mechanics of discounting are discussed in textbooks on Finance, or Cost-Benefit Analysis, under a chapter heading of Discounting, or with headings such as Present Value Analysis, Financial Calculations, Discounted Cash Flow Analysis, or Time Value of Money. Many calculators and computer spreadsheets have the appropriate financial functions, and accompanying instructions, necessary for discounting. The first step in discounting is to identify the timing and amount of each cost. The second step is to determine the appropriate rate to use for discounting. After these are determined, each cost is discounted over its respective time period to the present. The present in this case can be assumed to be the effective date of the regulation or when compliance is required. The discounted costs are then added with any other present costs to obtain the amount to be entered in B1.

GUIDELINES for the
Economic Impact Statement in STD. 399

Estimate the costs for the life of the regulations or for five years, whichever is shorter. Since most regulations last indefinitely, and the present value of future costs generally drops steadily over time, a five-year time span should provide reasonable cost information, while simplifying estimates of annual future costs. In addition, Executive Order W-144-97 that establishes this EIS also requires that proposed regulations undergo a sunset review at least every five years. If a different time period is more appropriate for specific regulations, that time period, and the agency's reasoning for its use, should be noted in the rulemaking record and used to estimate total statewide costs.

The discount rate represents a return that would have been generated if the money spent for compliance costs was invested. The actual discount rate used may vary depending upon the nature of the regulations. As an example, a discount rate may equal the interest rate of a security whose maturity approximates the life of the regulations. There are various published interest rates in newspapers and business periodicals that can be used by state agencies, as appropriate, to discount future costs.

Items B1(a) and (b) require an estimate of initial and annual ongoing costs for a small business and for a typical business. GC § 11342 provides the various sector-specific definitions of "small business". A typical business is one that generally represents the characteristics of those impacted by the regulations. Initial costs may include the cost of new equipment, staff training, costs associated with obtaining information about the regulations and their requirements, and other start-up costs. Under most circumstances, initial costs will be incurred in the first year following the effective date of the regulations. However, major regulations may result in start-up costs spanning a two or three year period. Estimate the average annual ongoing (recurring) costs for any 12-month period following the effective date of the regulations. A survey or sampling of affected businesses may provide valuable information regarding costs and other impacts.

Item B1(c) requires an estimate of the initial and ongoing costs that may be incurred by individuals. Initial costs may be the cost of an application, examination or licensing fees, education or training expenses, or special equipment or supplies. Ongoing costs may include, but are not limited to: fees; maintenance and service of items needed for compliance; price increases; barriers to entry such as increased education or examination requirements; and wage, employment or recreational opportunity changes. Individual means members of the general public, employees, applicants, students, taxpayers, property owners and any other natural persons.

The term "natural persons" is intended to distinguish impacts on individuals with personal interests from those whose business interests may be impacted. [GC § 11340.1(a) and 11346.5(a)(9) require an assessment of impacts on private persons].

Item B1(d) requests the agency to summarize any other broad economic effects of the regulation that the agency has identified. For example the regulations may result in: impacts on competitive markets, distribution changes, or loss of productivity. A discussion of such costs can be found previously in these guidelines, under "*Other Costs*."

B2 To the extent possible estimate the industries that will incur the majority of the costs reported in item B1, utilizing Industrial Classification code numbers whenever possible (see the previous discussion of item A2). Each industry's share of total costs may be estimated in dollars or by the percentage of total costs.

B3 Costs associated with reporting, record keeping, accounting, and preparing and maintaining other information and paperwork can be burdensome, especially for small businesses. Some costs that should be considered when completing this item are the expenses for hiring professionals to comply with the requirements. Also the dollar value of a firm's management and staff time to prepare and maintain required records should be addressed. Estimates should also include costs incurred to obtain the information needed to understand and comply with the regulations. The estimated costs should be shown here and also included in item B1.

GUIDELINES for the Economic Impact Statement in STD. 399

B4 GC § 11346.5(a)(11) requires that the *Notice* include, “A statement that the action would have a significant effect on housing costs, if a state agency, in adopting, amending, or repealing any administrative regulations, determines that the action would have an effect.” It further states that agencies “...shall make available to the public, upon request, the agency’s evaluation, if any, of the effect of the proposed regulatory action on housing costs.”

Housing costs pertain to all dwelling units, regardless of the number of inhabitants or type of structure. Dwelling units include single-family homes, duplexes, apartments, condominiums and manufactured homes. Housing costs are generally impacted by a variety of factors, such as interest rates, construction wages, materials, land and land development expenses, taxes, insurance, and permits. Estimate the total increase in housing costs and the cost per unit.

B5 Various GC sections require agencies to compare and explain differences between federal and state regulations. [GC § 11346.2(b)(6) and (c), 11346.5(a)(3)(A), and 11346.9(c)]. Although GC § 11346.2(b) only requires certain agencies to justify the cost of differing state and federal regulations, this item is designed to encourage all agencies to do so. Briefly identify the state-federal differences, if any, and discuss the need for the differences. Also, if there is legal precedence or authority cite the appropriate code section(s). To the extent possible estimate the costs associated with the differences.

C. Estimated Benefits

The purpose is to identify the amount of benefits, the timing and extent of the benefits, as well as the parties benefiting from the regulations. The quantification of the information requested is not specifically required by the APA, except when a proposed regulation by Cal/EPA, the Resources Agency, or the State Fire Marshall is different from Federal regulations and not authorized by law. [GC § 11346.2(b)(6)]. However, information on benefits is important, in part, because the California Legislature has found that “Substantial time and public funds have been spent in adopting regulations, the necessity for which has not been established.” [GC § 11340(c)].

Persons are presumed to be directly affected by the regulations if “...they derive from the enforcement of the regulation a benefit ...”. [CCR, Title 1, Chapter 1, Article 2, section 16(b)(3)]. Small businesses are affected if they “...derive a benefit from the enforcement of a regulation...”. [CCR, Title 1, Chapter 1, Article 2, section 4(a)(3)].

Prior to submitting the *Notice* to the OAL, agencies are required to assess beneficial impacts of regulations on business, including: the creation of jobs within California, the creation of new businesses, and the expansion of businesses currently doing business in California. [GC § 11346.3(a)(2) and (b)(1)]. Benefits should be quantified to the extent possible. A schedule of monetized benefits would assist in understanding the timing of benefits. Any benefits that cannot be monetized should be presented and explained.

Agencies are required to demonstrate by substantial evidence the need for a regulation. The evidence includes, but is not limited to, facts, studies, and expert opinion. [GC § 11349(a)]. The “necessity” requirement can be met, in part, by identifying any potential benefits that help to demonstrate the need for the regulation. Benefits can be any outcome that promotes well-being or an economic advantage to an individual or group. Some examples of benefits that should be considered when completing this portion of the EIS follow:

- Benefits can take as many forms as costs, although their nature will often be quite different. Most regulations have an underlying public welfare purpose, such as environmental protection, the management of natural resources, enhanced public health and safety, or consumer protection.
- Regulations to enhance health and safety, for example, may not only improve the quality of life, but may reduce medical expenditures and employee absenteeism costs. Regulations that increase reporting requirements may save well-informed consumers money.

GUIDELINES for the *Economic Impact Statement in STD. 399*

- Many major regulations are intended to provide environmental or natural resource benefits. If it is determined that resources will be enhanced through regulations, their increased value should be projected. Regulations can also reduce environmental waste and cleanup costs, or prevent new pollution from occurring. Some regulations may generate increased revenues for resource-based industries, such as higher crop yields to farmers due to cleaner air. Resource protection, such as the preservation of natural areas, may result in various ecological and societal benefits. Resource benefits can be difficult to quantify, since many environmental goods and services do not trade in private markets. Nevertheless, it is important to assess their value to justify the potentially high costs such regulations can impose.
- Regulations can also create economic market benefits when they solve a problem that is not being addressed by private markets. For example, government may be the most appropriate party to establish consistent and universal standards for widely-used products or technologies. Regulations can also generate international consumer confidence in California goods, such as agricultural products, by ensuring quality and content standards. Once identified, economic market benefits from regulations can be quantified in a variety of ways, such as by estimating reduced production and transaction costs or increased economic activity.

C1 This item requests that the information on expected benefits be briefly summarized here.

When an agency is not clear about all potential benefits, it should consider that the primary economic justification for regulation is to address a market failure. (Regulation may also be justified by some other compelling public need, such as to improve the efficiency of government.) The most common market failures include externalities, natural monopolies, market power, and incomplete or uneven information. An *externality* occurs when the action of one party imposes uncompensated costs or benefits on another party. (For example, oil spills that adversely impact commercial fishing.) A *natural monopoly* occurs when a market can be served at lowest cost by one producer, such as a local natural gas distributor. One or more firms exercise *market power* when they reduce their output below what a competitive market would sell, in order to increase their prices. *Inadequate or uneven information* can cause a market failure in a variety of ways, such as by reducing innovation, increasing market power to certain firms, or causing an inefficient allocation of resources.

C2 When a regulatory agency is required to develop regulations to comply with a specific statute, the statute may identify the benefits that should result from the regulations. Labor Code section 6357 provides an example: "...the Occupational Safety and Health Standards Board shall adopt standards for ergonomics in the workplace *designed to minimize the instances of injury from repetitive motion*" (emphasis added).

Regulatory agencies may also have express or implied authority to develop regulations. This authority is power granted by the Legislature or the Constitution to a state agency to implement or enforce a statute, and includes the power to adopt regulations. This item requires the agency to indicate whether the regulations are implementing a specific statute or are based on the agency's broad authority to promulgate regulations. Space has been provided to allow the agency to briefly summarize the goal or policy the proposed regulations address and to provide relevant citations.

C3 An attempt should be made to quantify benefits in monetary terms whenever possible. Benefits that cannot be quantified should be explained. Although it can be difficult to calculate the dollar value of benefits, it is generally possible to do so. For example, the quantification of benefits was a factor in federal decisions to reduce lead in gasoline. It was found that higher gasoline refining costs were offset by reductions in health care, automobile maintenance, and other costs, since lead emissions are toxic and corrosive.

There are a number of approaches to quantifying economic benefits. Different regulations may require a different approach, or a combination of approaches. The concept of willingness-to-pay provides one measure of the value of a benefit, since it represents the dollar amount that an individual places on a good or service, such as a safer automobile. Another approach to measuring benefits is to estimate the decrease in the cost of a good or service that results from a regulation. For example, a water quality regulation that eliminates the need for bottled drinking water provides a benefit by reducing expenditures for that product.

GUIDELINES for the Economic Impact Statement in STD. 399

The amount entered in this item should include both present and future benefits. If future benefits are expected, they should be discounted to present values, using present value analysis. Discounting benefits to present values generally follows the same steps as for discounting costs. (See guidelines for item B1 for a discussion of discounting costs.) The final step is to add the discounted benefits with any other present benefits to obtain the amount entered on item C3 of the EIS.

The benefits should be estimated for the life of the regulations or for five years, whichever is shorter. Since most regulations last indefinitely, and the present value of future benefits generally drops steadily over time, a five-year time span should provide reasonable benefit information, while simplifying estimates of annual future benefits. In addition, Executive Order W-144-97 requires all proposed regulations to undergo sunset review every five years. If a different time period is more appropriate for a specific regulation, that time period should be noted in the rulemaking record and used to estimate total statewide benefits.

The present value of benefits (item C3 of the EIS) will be compared to the present value of costs (item B1), in item D2, in order to determine the net present value of the proposed regulations and any alternatives.

D. Alternatives to the Regulation

The purpose is to summarize the alternatives the agency considered, and to provide information that documents the merits and limitations of the proposed regulations and any potentially effective and reasonably feasible alternatives.

All state agencies are required to describe, in the ISOR, the alternatives considered and the reasons for rejecting those alternatives. Agencies are also required to describe any alternatives that would lessen any adverse impact on small business. [GC. §11346.2(b)(4)(B)]. Agencies must include in the Final Statement of Reasons (FSOR), “A determination with *supporting information* (emphasis added) that no alternative considered by the agency would be more effective in carrying out the purpose for which the regulations are proposed or would be as effective and less burdensome to affected private persons than the adopted regulations.” Agencies must also set forth their reasons for rejecting any proposed alternative that would lessen the adverse economic impact on small business. [GC § 11346.9(a)(4) and (5)].

The record of the rulemaking proceeding must demonstrate by substantial evidence the need for the regulations. [GC § 11349(a)]. As a result, when an agency uses its broad authority to promulgate regulations, the agency should consider any reasonable and appropriate alternatives.

D1 This item is to be used by the agency to give a brief description of the primary alternatives that were considered, and why those alternatives were rejected. It is most helpful to regulated parties to identify alternatives early in the rulemaking process, and present them in both the ISOR and in this EIS. Early identification allows the public and policy makers to determine whether the proposed regulations are reasonable and appropriate, and whether other options were considered that could be less burdensome. However, if no alternatives were considered prior to submitting the STD. 399, briefly describe any attempts made to identify and evaluate potential alternatives.

This space may also be used to indicate whether any of the following more common types of alternative approaches were considered: not regulating; substitution of performance standards for prescriptive standards; alternative levels of stringency; different requirements for different segments of the regulated community; alternative effective dates of compliance; and/or market-based solutions.

The use of market-based solutions is a pragmatic and increasingly popular alternative to the traditional “command and control” (prescriptive standard) approach to regulations. Such solutions allow regulated parties to reach a regulatory goal by using private market incentives to influence behavior. For example, the purchase and scrappage of heavy-polluting cars, from willing private sector owners, could possibly reduce some air pollution at a lower cost than installing auto emission devices. Market-based incentives encompass

GUIDELINES for the
Economic Impact Statement in STD. 399

a variety of strategies, such as targeted subsidies and the market trading of environmental permits or emission allowances.

D2 The comparisons requested in this item are not specifically required by the APA. However, agencies are required to assess impacts and to select the least burdensome alternative that carries out the purpose of the regulations. This item, which incorporates standard economic practices, allows agencies to demonstrate that an economic analysis of potential alternatives was performed. The present values of costs and benefits were requested in items B1 and C3, respectively, of this EIS. These values should be entered here for the "Regulation". Estimates of the benefits and costs of alternatives should be prepared in the same manner, and presented here for each alternative considered. The benefits from alternatives and the proposed regulations may be similar, to the extent that the expected outcomes are the same.

The concept of maximizing net present value to determine the best regulatory approach is based upon the premise that benefits should fully compensate for any costs. Theoretically, those who benefit from the regulations could compensate those who bear the costs, and still be better off as a result of the regulations. In practice, the incidence of benefits and costs is often on totally different groups, so that the parties paying for regulations are not compensated in any way. Distributional effects are an important factor in any economic impact analysis, and should be analyzed and discussed in the ISOR and/or FSOR along with net present value.

If the present value of any benefits and costs cannot be quantified, enter "see below", and discuss the issue in item D4.

D3 An impact analysis that compares benefits and costs is not a fixed rule or precise formula that automatically overrides all judgment concerning proposed regulations. Instead, such analysis provides a methodical approach for organizing information and evaluating alternative courses of action (or inaction). The cost and benefit data that go into an impact analysis can be difficult to obtain, and are often imprecise. As a result, it is not unusual for estimates to be presented in ranges, or for best and worse case scenarios to be developed that reflect the uncertainty behind the assumptions used. Uncertainty is also basic to nearly every analysis, and its presence and implications should be analyzed and reported as part of any impact analysis.

This item seeks information concerning the strengths and weaknesses in the quantitative benefit and cost data previously presented for the proposed regulations and alternatives. As appropriate, responses should also discuss any special quantitative techniques used to develop the data. For example, cost-effectiveness analysis may be appropriate when benefits from competing alternatives are the same, or when benefits have been specified by statute. (Cost-effective analysis can also be used to compare alternatives with identical costs, but different benefits, to identify the alternative with the largest benefits.)

An inability to quantify benefits and costs is a quantification issue that should be summarized here as appropriate.

D4 The Legislature has expressed its preference for performance standards over prescriptive standards. [GC §11340, 11340.1]. Performance standards tend to give regulated parties the flexibility to meet regulatory goals in a more cost-effective way. Such flexibility is particularly important given the rapid changes in technology and information. Prescribed practices can quickly become costly and out-of-date as newer approaches are developed. Prescriptive standards can also give a competitive advantage to larger or more established firms and may discourage innovation.

GC § 11340(d) states: "The imposition of prescriptive standards upon private persons and entities through regulation where the establishment of performance standards could reasonably be expected to produce the same result has placed an unnecessary burden on California citizens and discouraged innovation, research, and development of improved means of achieving desirable social goals." Other GC provisions specifically require agencies to substitute performance standards for prescriptive standards, if they are as effective and less burdensome, and require agencies to consider performance standards as an alternative. [GC §11340.1(a) and 11346.2(b)(4)(a)]. The definitions of the terms "performance standard" and "prescriptive

**GUIDELINES for the
Economic Impact Statement in STD. 399**

standard” can be found in GC § 11342(d) and (f), respectively.

This item in the EIS is to be used to explain what performance standards were considered and why they were rejected. If the agency determined the proposed regulations represent a performance standard, it should briefly explain the basis of this determination. In addition, if performance standards were not considered as an alternative to the proposed regulations an explanation must also be provided.

E. Major Regulations

The purpose is to summarize the rulemaking requirements for major regulations proposed by any Cal/EPA board, office or department (BOD). [As required by H&SC § 57005 (Senate Bill 1082, Statutes of 1993)]. A “major regulation” is any Cal/EPA regulation that will have an economic impact of more than \$10 million on California businesses.

Each BOD within Cal/EPA must evaluate submitted alternatives before adopting any major regulation. The BOD is required to “...consider whether there is a less costly alternative, or combination of alternatives, that would be equally as effective in achieving increments of environmental protection in a manner that ensures full compliance with statutory mandates within the same amount of time as the proposed regulatory requirements.” Pursuant to H&SC § 57005(c), Cal/EPA has produced *Cal/EPA Guidelines for Evaluating Alternatives to Proposed Major Regulations (Guidelines)* for BODs within the agency to use in the evaluation of these alternatives. The *CAL/EPA Guidelines* provide additional information on the guidelines presented in this EIS.

The SB 1082 requirements for major regulations apply to Cal/EPA agencies after a 45-day notice has been issued, and comments have been received from the public. However, Cal/EPA agencies usually evaluate alternatives to major regulations before the 45-day notice is issued. Such alternatives would most likely be generated by Cal/EPA staff or from public workshops or other events held prior to filing of the *Notice* with OAL.

E1 If the cost of the regulation exceeds \$10 million, the regulation is considered a major regulation. Check the “Yes” box and complete the rest of E. Major Regulations. Otherwise, check the “No” box and then complete the FIS portion of the STD. 399 as appropriate.

E2 As stated in GC § 11346.5(a)(7)(c), any affected party may submit one or more alternatives to the proposed regulation that would lessen any adverse economic impact on businesses. H&SC § 57005(a) requires that the proposing BOD shall evaluate these submitted alternatives and “...consider whether there is a less costly alternative, or combination of alternatives, that would be equally as effective in achieving increments of environmental protection in a manner that ensures full compliance with statutory mandates within the same amount of time as the proposed regulation.” A BOD only needs to evaluate submitted alternatives that meet all the foregoing criteria.

In determining whether an alternative is “equally as effective”, Cal/EPA BODs should consider all relevant factors, including, but not limited to, the enforceability and the technological feasibility of the proposed regulation and alternative.

The cost analysis of the proposed regulation and alternatives should be conducted using the incremental cost analysis methodology described in the *Cal/EPA Guidelines document*. This methodology should also be used to perform an incremental cost-effectiveness analysis for each alternative or combination of alternatives submitted to the BOD.

Enter a brief description of the two best alternatives for which such an analysis was performed. The alternatives selected for comparison would generally be those with the lowest cost-effectiveness ratios.

E3 The *Guidelines* also provide a methodology to compute cost-effectiveness ratios for the proposed regulation, and each equally as effective alternative or combination of alternatives, over the time period

GUIDELINES for the
Economic Impact Statement in STD. 399

associated with the regulation. This item in the EIS should contain the ratios computed, as well as the total cost of the proposed regulation and alternatives. (The detailed results of the cost-effectiveness analysis should be included in the rulemaking record.)